

November 14, 1990

LETTER 1056

GLOBAL DEFLATION: I want all my subscribers to fully comprehend the following concept: today the whole world must be viewed as a gigantic flow-of-funds entity. Today, money moves internationally. If wheat is over-priced, money from all over the world moves out of wheat. If the stock of Time-Warner is a worry because the company is up to its neck in debt, money from around the world moves out of Time-Warner. If German ECU denominated bonds look undervalued, global funds pour into German ECU bonds. In other words, today all values must be considered in terms of global valuation and global money flows.

Consider this: if the dollar is in a bear market (which it most definitely is) and we, as Americans, are holding all our assets in dollar denominated items (i.e., our stocks, bonds, T-bills, insurance policies, etc.), are we losing money or aren't we? I say we're losing. In the new global world, if the currency that our securities are denominated in is declining, then our net worth (as far as world markets are concerned) is going down the drain.

You don't believe it? Then sell your 1000 shares of GM, take the money and go out and buy a BMW or a Toyota or a VCR or an Italian suit. Oh, you noticed that they've raised their prices, that they're very "expensive"? They've had to raise their prices, in order to make up for the losses they take when they accept depreciating dollars. You still don't believe it? Then take a two-week vacation in Europe and see what your dollars will buy.

But that's all just minor stuff. The **big picture** is this: our creditors, the people and nations that hold billions of dollars worth of US securities, they're losing their shirts (and pants and socks). How long will they continue to hold US securities? A while longer? Fine, but what happens if there's a dollar panic, an all-out dollar collapse? We'll find out in due time. When will it happen? It will happen when it is perceived that the deficits and the interest on the US federal debt is totally overpowering this nation, when it is perceived that compounding federal debt has taken this nation's finances past the point of no-return (see Investment Position).

What does it mean for the world that the dollar is in a vicious bear market? As I see it, it means world deflation. The dollar is the world's reserve currency. All central banks own dollars. Hundreds of billions of dollars are held overseas. As these dollars lose value, the effect is deflationary. Wealth, in the form of dollars held around the world, is steadily eroding. What we're seeing as the dollar slips to record low after low is an international bear market in wealth.

I call this phenomenal dollar decline "the secret panic." Nobody seems to be noticing it. It's extraordinary, astounding! The wealth of the US (in terms of the hard currencies) is going down the drain and NOBODY NOTICES.

THOUGHTS: The public is loaded with muni bond funds and bonds of all kinds, and all along I've been wondering how the market is going to separate those bonds from their owners (the market ultimately kills any category of securities the public is loaded with). Answer: these bonds are all dollar-denominated, and once the panic to get out of dollars moves into high gear, the bonds will head south in earnest.

UTILITY STOCKS: The "smart boys" have been buying the utilities thinking that this is the safe and sure way to beat a recession. That approach hasn't worked in the past, and it isn't

Nov. 2 DJIA 2490.84; PTI 3170; A-D Ratio -18.03
Nov. 9 DJIA 2488.61; PTI 3165; A-D Ratio -17.72
Dow Yield: 4.09%; Dow P/E: 13.0; DowPow: -954
Dow 200-day MA: 2688; Dow 30-day MA: 2425
Dow Book Value: 1276; PTI 89-day MA: 3226
Percentage of Undervalued Blue-chips: 34%

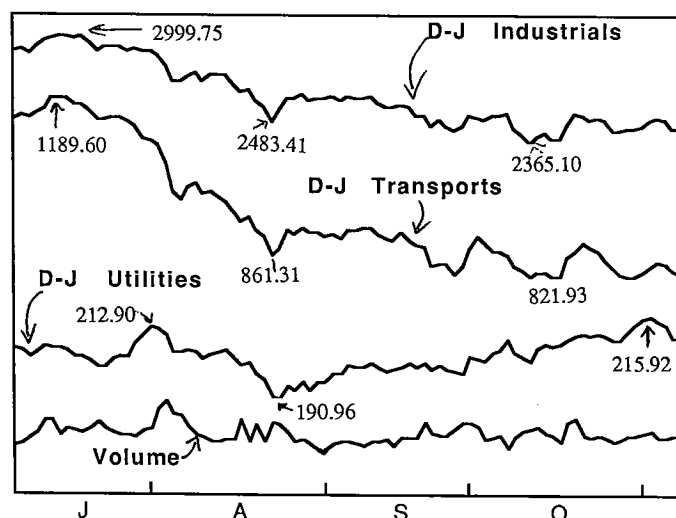
going to work this time. Did anybody ever tell the utility-buyers that when times get rough (and I mean rough) people turn off the lights (except the ones they need for reading), and they also do with less heat. Sound impossible? I grew up in the '30s with that psychology very much in mind. Furthermore, the utilities would be prime victims of an interest rate squeeze.

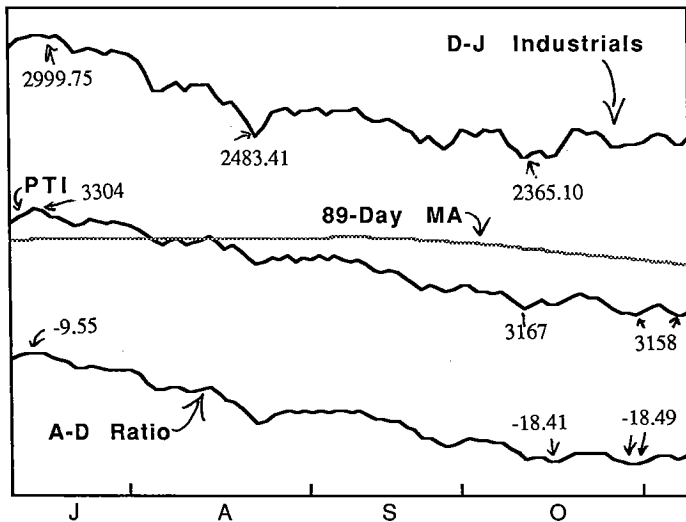
BOTTOM PICKERS: Can the investment geniuses be right -- are there great stock bargains laying around, just begging to be plucked? Omaha investment idol Warren Buffet recently bought 9.8% of Wells Fargo (at considerably higher prices than the stock is selling for today). Larry Tisch, CBS' CEO and an investment guru (he's been bearish for years), has turned around and bought a slew of assorted bank stocks (most at higher prices than they could be bought today). And the high priest of mutual funds, fabled John Templeton, has stated (*Business Week*, Nov. 5), "I have never seen so many stocks, specifically the shares of emerging growth companies, so grossly undervalued by the market."

Says *Business Week*, "Templeton expresses little concern over the market's sharp decline since last summer . . . He scouts for winners primarily among shares of small and little-recognized over-the-counter companies whose earnings have been growing at annual rates of 15% to 40% . . . Templeton has taken advantage of the fall to scoop up these shares for various *Templeton* funds."

Let's face it, these guys have been very, very good. Their records are superb. They have been brilliant about picking values, and recently they have been buying.

But wait -- is it possible that they could all be wrong? You're damn right it's possible. Now mind you, I'm not guaranteeing they're wrong. These fellows know values -- they've made billions of dollars via their knowledge of values.





However, what I'm saying is that this is a bear market, and I believe it's a bear market that's got further to go -- a lot further. If that is true, if I'm correct, then today's stock buyers are going to be disastrously wrong, and the cheap stocks, the bargains -- are going to end up as much greater bargains than they are today.

On top of all the above, corporate "insiders" have been buying their heads off. According to *Market Logic* of Ft. Lauderdale, Fla., "During the last 30 days, 79% of insiders executing open-market trades in their companies' stocks were buyers; 35% is normal." In other words, these fellows are extremely bullish about the trend of their own company's stocks. They've bought four shares for every one they've sold.

So I say to myself, "All this is what makes the stock market such a fascinating place. It's a place where the smartest investors in the world can be brilliant and make fortunes -- and then turn around and be dead wrong and lose their shirts."

Of course TIMING is a key. A bull tide can make a hero of an intelligent investor. Conversely, a bear tide can drive that same investor (if he remains stubbornly bullish) to his financial grave.

WALL STREET and MAIN STREET: A study of history tells us that when storm clouds form on the financial horizon, it is Wall Street that feels the cold winds first. Back in 1987, after the great crash, I wrote that forthcoming trends affect Wall Street FIRST -- but in due time, the rest of the country will follow Wall Street's lead. And that's exactly what has happened. Wall Street was hit hard after the '87 crash, and it was rocked again after the '89 crash. Time passed, but this year, in 1990, the nation began succumbing to the pains and troubles that had earlier enveloped Wall Street.

In the meantime, conditions on Wall Street itself and throughout the investment business have deteriorated badly. Here's the opening paragraph of *Business Week's* cover story (Nov. 5): "Wall Street is in a deep funk, and the signs are everywhere. Once jammed restaurants in lower Manhattan are all but giving away food to get people in the door. Pedestrian traffic has thinned out so much that sidewalk bootblacks have left for other parts of town. Over the past two years, tens of thousands of Wall Street workers have been given pink slips. Industry profits have plunged. And a potentially ferocious bear market looms."

On top of all this, New York City itself, its tax base ravaged and its expenses going sky high, is in deep financial trouble. With a whopping \$2 billion deficit to deal with, the City is wondering how it's going to wiggle out of its current financial strait-jacket. Real estate prices in the City are sinking and major corporations are leaving for other parts of the country. Mayor Dinkins is being subjected to daily ridicule, and crime statistics continue to set new records.

The big question, of course, is whether what's happened so far to Wall Street and the nation is the worst that is going to happen -- or whether what we've seen up to this point is merely the prelude to a long, extended, vicious bear market, a bear market that will ultimately try men's pocketbooks as well as their souls.

Here's my answer. I've stated this many times before, but I'll repeat it for new subscribers. A primary bull market carried from 1974 to 1989. It was a long bull market lasting 15 years. During those 15 years, the US had a love affair with debt; the nation became leveraged to the hilt -- from individuals to corporations, from cities and states to the federal government, from its banking system to its insurance companies and S&Ls. All this was accompanied by continuing inflation and excesses of every type and variety.

Then something snapped (as it always does during a financial "bubble"). That snap is called the beginning of a primary bear market. What happened was that the financial system couldn't continue to finance the surging deficits. Another name for a bear market is pay-back time. And that's exactly where we are now -- the markets are telling us, in the most decisive way they can, that it's pay-back time.

People are hoping that the bear market will be over quickly ("After all, isn't the Dow down 25%, and hasn't the Value Line Composite actually dropped below its 1987 crash low?"). But you don't cure 15 years of excesses with a one-year smash in the stock market. The big squeeze, the major liquidity problems, the big pain, as I see it, (unfortunately) lays ahead.

Up to now, it's been liquidity, the booming money supply, that has kept the monster total US debt afloat. It is estimated that there is roughly \$13-15 trillion in all types of debt in the US today. At an average interest of 8%, that means that over \$1 trillion a year in interest is needed to keep this \$13-15 trillion in debt afloat.

But here's what I see ahead. I see the US moving into a period in which it will not be able to generate enough money to pay the interest on its debt. At that time there will be a panic for cash. Everybody will need cash -- the public will need cash to pay off their loans and to keep up their standard of living, and the corporations will need cash to keep them this side of bankruptcy. Needless to say, every city, country and state will need money, and the federal government will be the biggest bidder of all for cash.

The consensus today is that interest rates will be heading down as the recession wears on. Two weeks ago, Dr. Henry Kaufman predicted a severe recession, but with long T-bond rates dropping to as low as 6.75%, I disagree. I see the time when US credit will be in disrepute and when the US government will be forced to pay near or above record high rates in order to sell their long bonds (the old record was 15.25% during 1981).

I think the bear is saying that the US (in all areas) can't generate that kind of money (short of all-out inflation). But look what's happening. M-4 (termed "liquidity"), which is the broadest measurement of money, is now growing at only a 2.2% rate. Adjust for current inflation and liquidity is sinking at a 3.5% rate -- and that's deflationary.

The normally optimistic *Business Week* (same issue) had this to say about the budget: "In the next five years, even assuming that the budget deal sticks, the US will spend nearly \$1.6 trillion more than it collects in revenue. That means that it will have to borrow more in the next five years than it did from 1975 to 1985."

If this is true, then at an 8% average interest rate, the US will, by 1995, be adding interest costs of \$128 billion to the federal deficit (actually, I think *Business Week's* estimate is optimistic). But what this shows is that the US is in the process of compounding its debt structure into a totally-out-of-control, deflationary monster.

All debt ends up in one of three ways. (1) It is paid off. (2) It is "put off," which means it is refinanced. (3) It is reneged on, which is a nice way of saying that it goes into bankruptcy.

With the deflation of the money supply, what we're going to see (and what we are seeing) is a lot of refinancing, and a lot of bankruptcy. Which is basically what this bear market is all about. The optimists are talking about "bargains" in stocks and "great values" and "below book" and "still good earnings," and they may be right (at least for now). But these people are looking out the wrong window.

Wall Street is looking through the debt window, and it's frightened to death at what it sees. So Wall Street is protecting itself. How does Wall Street protect itself? It shrinks, it fires people, it lays off divisions and departments, and it puts securities on the down-escalator. Declining prices is the way Wall Street protects itself. And make no mistake about it -- that's the path we're on now.

PRICE ACTION: Near-Term: Having recorded a bear market low of 2365.10 for the D-J Industrials and 821.93 for the Transports, the Averages have been rallying, bouncing, backing-and-filling -- using up time. I stated in the two previous Letters that the angle of descent in the Dow was too steep, that the market had gone down too far too fast. At the rate it was going, the Dow would reach zero in mid-1991, and that wasn't going to happen.

So the market has been using up time, pushing a bit higher, trying to suck in a new supply of optimists. During the last few weeks, (despite the bounce in the Dow) -- the A-D ratio, the Value Line Composite, the NYSE Financial Index, the AMEX and the NASDAQ indices all recorded new bear market lows.

On the other hand, the Utility Average and Treasury bonds headed higher. Ordinarily, I would have bet that higher utility and bond sectors would be sure to rub off on the rest of the market. But today everyone and his brother is citing the superior action of the Utility Average, and brokers are using the Utility action as a sure harbinger of better times to come.

For this reason, I view the better-acting Utility Average with skepticism. Investors, almost to a man, believe that as this nation's economy weakens, interest rates HAVE TO COME DOWN. I remain skeptical. I continue to believe that a full-blown liquidity crunch lies in our future. With it will come a shocking surge in rates.

DOW'S 50% PRINCIPLE: I'm looking at the BIG picture, and when you talk about the big picture you have to bring in Dow's 50% Principle. Charles Dow always paid careful attention to what the averages did at the halfway mark of any major advance or decline. The market responds to many basic principles of physics, and the 50% Principle can best be described in the following terms.

I compare the 50% Principle to the action of a child's see-saw. Two children are seated at opposite ends of a see-saw. One child pushes up with his legs and his end of the see-saw rises. If his end rises almost to the level (horizontal) position but not above it, he will probably sink back down to his original position at ground-level again. But if his kick is sufficient to push him above the horizontal position, he will rise to the highest level of the see-saw.

Let's look at the stock market in the same way. The Dow embarks on an extended rise. Following the rise, the market corrects. If, on the correction, the Dow can hold above the 50% or halfway level of the preceding rise, it is probable that the Dow (in due time) will advance to test the old high again.

On the other hand, if the correction takes the Dow below the halfway level, this represents bearish action, and in that case we can expect the Dow (in due time) to approach or violate that low from which the entire advance began.

Long experience with Dow's 50% Principle shows that the more extended the rise, the more valid the Principle. So here are the situations that I am watching.

(1) The bull market for the Dow began in 1974 at 577 and ended in 1990 at 3000. That represents a rise of 2423 points. The halfway

level of this entire rise is 1788. Thus 1788 is a critical level for the Dow. It is most important that this bear market halts for the Dow this side of 1788. If the Dow breaks decisively below 1788 we are looking (in my opinion) at disaster, since a wide-open break of 1788 would mean that the Dow was heading down for a probable test of the 1000 (and below) area.

(2) The 1987 crash low for the Dow was 1738. The Dow rose 1262 points from there to 3000. The halfway level of that rise is 2369. Thus, I view the **2369 level as important**. Under the 50% Principle, a decisive drop below 2369 would put the Dow in line to test or penetrate the 1987 crash low of 1738.

(3) The shortest test of the 50% Principle was this: the 1989 mini-crash ended at Dow 2569. From the '89 crash low, the Dow advanced to 3000, a distance of 431 points. The halfway level of that rise was **2784**. Unfortunately, the Dow has already violated the 2784 level -- violated it decisively. That violation triggered the 50% Principle, which meant that the Dow was fated to test the level at which the 1989-90 advance began. That level was 2569. Thus, the first forecast of the 50% Principle has already come true -- the Dow approached, then dropped decisively below the 2569 level.

PRICE/EARNINGS, DIVIDENDS: People don't seem to understand that in a big bear market stocks go down not only because of earnings decreases and dividend cuts, they go down because price/earning ratios go down. Thus, a stock may be doing well, even increasing its earnings, but the market decides that the stock's price/earnings ratio is out of line with average price/earnings for the rest of the market. Thus, this well-managed stock, this stock with actual rising earnings, will see its price/earnings ratio drop from say 20 down to 10. Consequently, the shocked stockholders will see the price of their lovely, profitable stock drop in half.

DIVIDENDS: Looking back over history, it is very rare to see total Dow dividends decline on a year-to-year basis. There are exceptions. Dow dividends were \$12.75 in 1929. By 1932, they had dropped to \$3.40, a shocking collapse of 73%. Again in 1937, Dow dividends had recovered to \$8.78. But the ensuing bear market dropped Dow dividends to \$4.98 in 1939, a drop of 43%. In 1941, Dow dividends had risen to \$7.56. By 1943, they had sunk to \$6.30, a drop of 16%. In 1964, Dow dividends were \$31.24. They slipped off to \$28.61 in 1965, a drop of 8%.

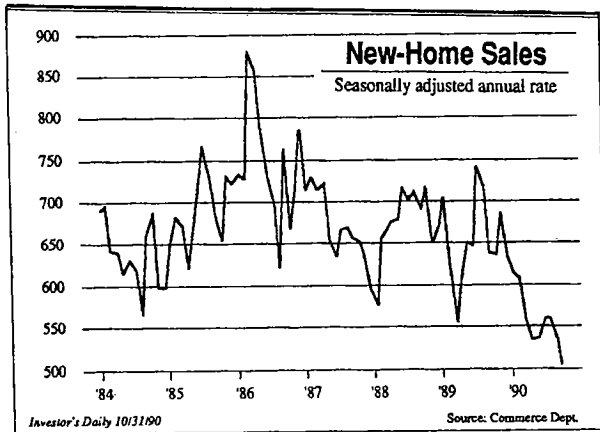
Since then, there has not been an important decline in dividends on a year-to-year basis, although there were very minor declines in 1967, in 1969, and in 1982.

Starting with 1982's Dow dividends of \$54.14, total Dow dividends have risen every year to the current \$103. So the big question now is -- will Dow dividends on a yearly basis drop during the course of this bear market? I think they will.

It is notable that even in the disastrous 1973-74 bear market Dow dividends actually increased. The 1973 Dow dividends were \$35.33, 1974 dividends were \$37.72 and 1975 dividends were \$37.46. And this even though the Dow collapsed from a high of 1051.70 in January 1973 to a low of 577.60 in December 1974, a drop of 45%.

But as they say -- that was then and this is now. And remember -- the debt and liquidity situation today is far worse than it was during the 1970s.

ECONOMICS: On October 31, the Commerce Department announced that the GNP for the third quarter grew at an annual rate of 1.8%. A day later, it was announced that sales of new single-family homes (a segment of our largest industry) for September were down 6% from August and down a whopping 21% from September '89 (see chart). In the meantime, our second biggest industry was suffering as GM prepared to close 11 plants and take a \$1.8 billion write-off. Ford announced that third quarter earnings were down 79%. Oh yes, the GNP estimate will be revised on November 28 and again on December 19. The 1.8% estimate was released before the election.



On November 28, the *WSJ* included a front-page story entitled, "Recession Fears Have Some People Depressed." The November 5 *Newsweek* magazine offered a cover story with the screaming title, "How Safe Is Your Job? -- the Warning Signals, How to Cope."

C.J. Lawrence's Ed Hyman, Wall Street's favorite economist, has grown more pessimistic. In his latest mailing, Ed writes: "Severe recession indicated. Up until the last two weeks, there was virtually no evidence that the economy was falling apart. That has changed. With extreme weakness reported in Consumer Confidence, Consumer Sentiment, the Philadelphia Fed Business Activity Index, Unemployment Claims, and Help Wanted Advertising, there is a possibility that fourth quarter Real GNP will decline at a 5% annual rate."

INVESTMENT POSITION: I grew up believing that the dollar was "as good as gold", that this was the "biggest, the best, the safest country in the world", that "anything foreign was shoddy, suspect or too exotic to deal with". And the fact is that the average American still feels that way.



Furthermore, this whole country and its corporations and institutions still feel pretty much that way. Go to your local bank and tell them you want to buy Swiss francs. They'll look at you with blank, uncomprehending eyes. Tell your stock broker you want to buy German government bonds. He'll scratch his head and try to sell you AT&T.

For many months now I've been telling my subscribers to diversify OUT OF DOLLARS. I don't know how many of you have done that, but here I go again. You can use Citicorp, you can use Mark Twain Bank of St. Louis, you can use Swiss Bank Corp. (offices in NY, Atlanta, LA, Chicago). You can even check your brokers to see what they offer (it isn't going to be much). My advice -- get busy, call one or all of these outfits, get familiar with your options, but MOVE.

I've been getting calls from Swiss banks, good banks, Overland, Bank CIAL, all anxious to deal with my subscribers, but I simply find it easier to deal with a bank that has offices in the US and that's why I mention Swiss Bank Corp.

There are no perfect or great investment solutions in this global bear market. The only answer I can give is a non-answer, and that's diversification. I like gold and cash, but cash does not mean just dollars. Cash is T-bills and foreign currencies. I believe the safest place to be as this bear market slowly (it will speed up later) takes its toll is in gold, T-bills and foreign currencies. That's where I've been moving to -- so why should I tell you anything different?

NOTES & QUOTES: Faye and I spent the weekend of November 2-4 in New Orleans, where I spoke at the Blanchard seminar. I also held two workshops (about 125 people in each), and I stated that in bear markets everyone loses, whether it be in home values, stocks, bonds, land, etc. Then I asked the audiences for a show of hands of all who thought they were ahead in total asset value over this time a year ago. NO ONE raised their hands. Lots of talk about the deficit on the part of speakers. It's finally getting across that DEFICITS DO COUNT. . . . As for New Orleans, if you ever go there, eat at the Commander's Palace. I'll make this statement: It's the best restaurant value, dollar for dollar, in the US (full dinners, from great appetizers to salad to entrees to great desserts, run under \$30). A comparable dinner in NYC or LA would run twice that. New Orleans is in a recession or worse -- every other building downtown appears to be for sale.

La Jolla's beautiful La Valencia hotel has been a landmark here since the 1920s. A week ago the *San Diego Union* published a comparison of the Valencia's menu in 1941 vs. the menu today. It's really a story of the collapse in the purchasing power of the dollar. Here it is -- read it and weep.

1941	1990
New York Cut Steak Dinner Choice cut of Steer Beef broiled to your taste. Served with a fresh vegetable, french fried potatoes, green salad, rolls and coffee. 1.10	New York Cut Sirloin Steak 19.75
Filet Mignon Steak Dinner Choice cut Filet Mignon, stripped with bacon, and broiled to your taste. Served with French Fried Onions and potatoes, hearts of lettuce salad, rolls and coffee. 1.15	Roast Prime Rib of Beef with Creamed Horseradish 20.50
Combination Sea Food Fry Fried Eastern Oysters, Scallops and Shrimp assorted, or your choice. Served with a fresh vegetable, potatoes, rolls and coffee. .90	Roast Rack of Lamb Served with Jalapeno and Mint Jellies 23.50
Fresh Lobster Thermidor Fresh local lobster diced in a delicious sauce of cream, mushrooms, cheese and sherry. Served with a fresh vegetable, hearts of lettuce salad, rolls and coffee. .90	Mixed Seafood Grill Lobster, Sea Bass, Scallops, Crab, Shrimp with Ratatouille 20.50
	Shrimp and Lobster in a Warm Vinaigrette 23.50
	Free Range Chicken Marinated with Olive Oil and Fresh Herbs 15.75

Soak the rich? They're already being soaked. The top 1% (in income) Americans (people earning \$157,000 or more), pay 24% of all federal taxes. In California, the 5.7% of married couples who earn more than \$100,000 pay more than half of the state's income taxes.

From the Nov. 2 *Christian Science Monitor*: "The real scandal highlighted by the Keating affair is not the actions of a few individuals. The real scandal is that . . . Congress still hasn't put teeth into campaign-finance reform. Bills to curb the power of PACs and close loopholes for 'soft money' (the loopholes that Keating pushed money through) were allowed to languish."

Is the great art boom ("bubble") of the 1980s over? The market thinks it is. Sotheby's stock at the high was 33 -- it hit a new low of 9 1/4 last week. And its auction of modern paintings last week was a major disappointment, where only 34 of 77 items offered for sale actually sold. Sotheby's estimated that the sale would bring in upwards of \$40-50 million, it brought in only \$19.8 million.

Time is running out on whatever it is that Bush has planned for the Mideast. The Saudis are having second and third thoughts regarding an attack on Iraq. Said one Western diplomat, "The Saudis' experience in warfare has been Bedouin raids where nobody dies. Now that they see Iraq's capabilities, there's a growing realization that this is not going to be a picnic." Another expert says, "The most basic Saudi worry is that a military conflict could destroy the sophisticated Saudi infrastructure created by oil profits." States the editor of a Saudi newspaper, "We don't want a strong Arab army (Iraq's) to be destroyed, since it will alter the balance of power in the region in favor of Israel." Said a Saudi intellectual, "If you make Iraq a parking lot, you make Iran a regional superpower. And we don't want that." Russell comment: Good luck, Mr. Bush. The way the Mideast is going, it could end up as the military twin to the budget mess.

One thing is clear -- Iraq continues to build its military capabilities, including nuclear. For that reason, I don't see what options Bush has except to go in, to attack. Bush has put the military there, he sees the mounting danger. I put the odds for war at 2 to 1 for war.

While some analysts are still arguing about whether the nation is in recession or not, others are saying something worse -- that we're moving into depression. What's a depression? Ray Dalio (quoted in *Barron's*) of *Bridgewater Associates* writes: "Recessions occur when the Fed tightens monetary policy, usually to fight inflation (which causes consumption to fall and savings to rise), and ends when the Fed eases (causing consumption to rise and savings to decline). A depression is a self-feeding contraction brought about by incomes falling faster than costs, primarily due to high debt-cost service burdens, which in turn, leads to a crisis among financial intermediaries and extreme discrimination in lending. In a depression, unlike a recession, the economy does not respond to central banking ease -- and both consumption and savings fall." Dalio believes that what we're moving into is depression, not recession.

Eliot Janeway in his *Janeway Letter* notes: "The fundamental distinction between the start of a depression and a recession is about to make the news . . . Depressions are precipitated by financial disturbances which shut borrowing down or even off. Ironically, these disturbances hit as surprises when borrowing has been heavy and is depended upon to support high activity and employment. Such disturbances last longer and do incalculably more damage than slow-downs caused by inventory accumulation." In the sister *Janeway Guide* he notes: "The banks are shut to borrowers; they're so hard-pressed that some of them are even putting pressure on top-notch borrowers to prepay in order to release money to carry bad loans. It's a formula for trouble, as desperate strategies generally are." Russell comment: My old friend, Eliot Janeway, was formerly business editor of *Time* magazine -- he's been around a long time, and he's seen it all. He expects depression.

On November 1, the Bundesbank (the world's most independent central bank) raised the German Lombard rate 1/2% to 8.5% (France had reduced its bank rate a few days before!). The move came in the face of a gathering US recession, and in the face of a Fed which is being pressured to bring rates down. Germany is a country that will not tolerate inflation. The Germans are as afraid of inflation as the US is of deflation. At any rate, you can see why the D-mark will probably emerge as the world's strongest currency (at least, until the new single European currency is born, if it ever is born).

The "new" budget and tax trimmings are now history. The Democrats ducked the job of reducing the deficit and instead turned it into a "tax the rich" and "fairness" game. Mr. Bush put on a dreadful, no-brainer performance and the Republicans came out smelling like dead fish. The fact is that if you taxed away all the income of all the millionaires in America, you wouldn't come close to balancing the budget. Comparatively speaking, there just isn't that much money there. The big money resides with middle-class America, and if you're really serious about raising big bucks via taxes, that's where you have to go.

George Will reminds us of the story about Andrew Carnegie, the great steel tycoon. When an ardent socialist harangued him about redistribution of wealth, Carnegie called in his secretary and asked him for two figures -- the world population and the value of all of Carnegie's assets. Carnegie then divided his assets by the population figure and turned to his secretary, "Give this gentlemen sixteen cents. That's his share of my net worth."

First they take away all the tax shelters while lowering the income tax rates. Then they take away the deductions, boost the Alternative Minimum Tax and raise income tax rates. And that's just the feds. At the state level, taxes are going up as well. In the high tax states such as NY or California, higher income people (victims) are paying close to 50% of their income in taxes. In NYC the

"unthinkable" is being discussed -- another tax increase. But who's complaining? After all, look at the improvement in our "quality of life."

Speaking of quality, the quality of state and municipal financing is coming increasingly into question. I'm particularly interested in this area, since the public is so loaded with muni bond funds. Along these lines, Jim Grant's latest report (*Grant's interest Rate Observer*, 233 B'way, NYC 10279) lists some of the so-called "one shot" borrowings by New York state. Here are a few: NY state borrowed \$325 million from the State Insurance Fund, \$133 million from the Tax Stabilization Reserve Fund, \$780 million from the Insurance Fund, \$170 million from the Aggregates Trust Fund, \$84 million from the Hazardous Waste Remedial Fund, \$30 million from the Housing Finance Agency, \$36 million from the Court Facilities Fund, \$45 million from the Urban Development Corp., and on and on. The total of these "one shot" borrowings is an astounding \$1.8 billion. It makes one wonder what happens if a severe recession hits and tax receipts in New York collapse. One thing that will happen is that a lot of states agencies will be broke . . . New Yorkers used to move to New Jersey to escape New York's onerous taxes. Now New Jersey has done what *Forbes* magazine describes as levying "the largest state tax increase in the nation's history".

Malcolm Forbes Jr., editor of *Forbes* magazine, starts his "Fact and Comment" column this way:

THE MOST UNDERPRICED ASSET IN THE WORLD

The dollar.

You may be right, Malcolm, but the dollar is also the most mismanaged of all the major currencies.

Ashby Bladen continues as the maverick columnist of *Forbes* magazine. This is from his latest column: "Because they believe these things can go on indefinitely, the economists are giving us some very dangerous financial advice. They believe that any kind of trouble is a signal to buy long-term bonds because the Fed will always try to cure it with easy money. They may be right about the Fed's intentions, but this time the end result of continuing to play by the new rules will be the destruction of our foreign creditors' already weakened confidence that we have any intention of honoring our debt at anything like the current value of the dollar. Then we, like any other doubtfully creditworthy borrower, will have to pay with peak interest rates. . . Ahead of us lie not a bond market rally but new crisis peaks of long-term interest rates exceeding the 15 1/4% that was the peak yield on the long Treasury bonds in 1981." Russell comment: Interesting contrary opinion, isn't it. By the way, this guy is no dummy.

California real estate prices are finally weakening, and in many areas prices are down 10% to 20% and more. Vacancy rates in California commercial properties are surging. California accounts for 15% of this nation's GNP, and up to now California has been a bastion of strength. That's about to change.

GOLD: There have been a number of very obvious "hits" in the gold market this year. The rumor (I believe it's more than a rumor) is that a Middle Eastern syndicate is manipulating the price of gold. First, they accumulate a big position, then they dump it on the market, knocking the price down. They then accumulate gold again, and knock it down again.

How long can this game go on? As long as the gold market continues sluggish. On the other hand, there does seem to be a floor under gold at the 350-60 level. I'm guessing that at 350-60, central banks step in and buy gold, and that's about the story in gold at this time.

What will be the next major move for gold? I discuss the world deflationary picture at the beginning of this Letter. I believe that deflation throughout the world will become increasingly severe as the months go by. At some point, the central banks of the world will get together and decide that they have to reflate. That is the point at which gold will take off. In fact, since gold is a part of

every central bank's reserves, the banks might even decide to arbitrarily raise the price of gold, raise it high enough so that it will make a major difference in the value of each bank's reserves.

Remember, the reserves of every central bank are composed of gold and foreign currencies (the foreign currency in almost every case being the world's reserve currency -- dollars). As the world price of the dollar declines to successive record lows, the value of the central banks' reserves declines accordingly. Thus, the steadily declining dollar exerts a very deflationary effect on the world picture.

There is a general perception that gold can only rise on the basis of inflation. This is not true (remember, gold was arbitrarily marked up from \$20.42 to \$35 during the deflationary 1930s). Gold can also act as an island of safety in the case of a world financial panic. In a global panic, doubts could well arise about the value or stability of ALL paper currencies, in which case there could be a mass move into gold.

In other words, what I'm saying is that there is more than one reason why investors should accumulate gold. The primary trend of the markets is now bearish. In a bear market no one knows what will happen or how bad things might become. This is the argument for diversifying part of your assets into the actual metal.

LATE THOUGHTS: The banking systems of the world are in poor shape. Last week, *Moody's* cut the ratings on four of Japan's largest banks. Only one major US bank (J.P. Morgan) still carries the highest (AAA) rating. The Swiss "big three" banks, Credit Suisse, Union Bank and Swiss Bank Corp. are still top-rated. The International Banking Credit Analysis (IBCA) gives only seven banks in the world an A rating and the Swiss "big three" are all in that rarefied group of seven.

This headline (dated Nov. 12) refers to the latest rundown by the widely-followed *Blue Chip Economic Indicators*. This service notes that 75% of the 55 economists that they poll are looking for any economic downturn to last no longer than two or three quarters. Added the newsletter, "An even larger majority -- 82% -- anticipate that the recession will be relatively mild."

Top Economists Predict Brief, Mild Recession

By JOHN D. McCLAIN
Associated Press Writer

WASHINGTON -- The vast majority of top economists in a monthly survey believe a recession will begin before year's end, but most predict it will be brief and relatively mild, a prominent economic newsletter reported.

Blue Chip Economic Indicators said 80 percent of the 55 economists in its survey feel a downturn will start before the end of 1990. Another 6 percent said the slump would start in 1991.

If you remember, only three or four months ago the consensus among economists was that there would be no recession at all. The new consensus is that it will be a short, mild recession. Will the consensus be wrong again? I think so.

I'll remind subscribers that I believe the early stages of this bear market (where we are now) will be dragged-out, frustrating and deceptive, with many gurus and "experts" arguing about whether we're in a bear market and whether we're in a recession. This bear is going to slowly and slyly envelop the nation. It's not going to be "clear, pure and simple" as per 1973-74, it's going to be extended, complex and severe -- with the most severe part coming much later in the bear market.

A number of analysts are stating openly that the "worst has been seen" as far as the market is concerned. Others, more cautious, are saying that if nothing else, the Utility Average has seen its low.

I don't agree. In the past, major bear market lows have been quickly followed by "buying stampedes" in breadth. So far, a characteristic of this rally has been the sluggishness of breadth. This rally has been basically a Dow rally with breadth reluctantly tagging along. This hardly bespeaks of a bear market bottom.

As far as the Mideast is concerned, I find that most analysts are looking for (1) a US attack on Iraq, followed by a quick victory and and therefore a rapid end to the war, OR (2) a no-combat US victory whereby Hussein does the bidding of the US and pulls quietly out of Iraq. Either action, we are told, will bring back the old bull market.

Again I disagree. This bear market started before Hussein moved into Iraq, and this bear market will be around after Hussein leaves the scene (whether he leaves the scene one way or the other). I'm sorry to have to say this, but the US' problems are a lot bigger than Saddam Hussein and Mideast oil. The US' problems have to do with decades of financial mismanagement, budgets totally out-of-control, and compounding debt.

So far, none of these financial problems have been solved. In fact, they're worsening. Furthermore, neither Congress nor Mr. Bush have been telling the American people the truth about the problems. I'll be charitable -- I don't think Congress or the President know or comprehend the depth and the extent of the real problems.

How can we make our "representatives" in Washington understand what's going on? The best way would be to send each and every one of them a book of compounding tables. Then, if they studied the tables carefully, they might have some concept of the basic problems of debt and financing that the US is facing today.

LATE MARKET: As noted in the front page statistics, the 200-day moving average for the Dow is currently 2688 and dropping at the rate of about a point a day. So the Dow is still far below its 200-day MA. Considering that the market has been oversold ever since July, it would not be unusual for the Dow to rally back and approach, or even touch, its 200-day MA -- before the bear market resumes to the downside. The Dow has already climbed above its 30-day moving average (the 30-day now stands at 2425).

I don't know how many other investment services I read, maybe 40. But it's incredible to me to note how many of these services have remained stubbornly bullish throughout the 1990 collapse. For instance, one service has been bullish on the big bank stocks all during 1990. Now that banks such as Citicorp and Chase have lost up to 80% of their peak value, what does this same advisory say? It says what it has been saying all along -- the bank stocks are a buy. And I think to myself, "They may be a buy but what would I buy them with? If I had listened to this outfit I'd be broke."

Further, I note that for all of 1989 and 1990, most of the advisory services that I read continue to pick "stocks to withstand the recession" or "stocks to outperform in a bear market." Few of these advisories ever talk about the correct stance in a primary bear market -- which is on the sidelines, devoid of stocks. This is because these outfits are possessed with the "buying mentality" learned during the 1980s. Most have never had to deal with the deceptiveness and treachery of a bear market. And they don't understand the crucial difference between missing a possible profit (during a bear market rally) and taking an actual loss -- losing one's capital.

In a bear market we must reverse our thinking. In a bear market the object is to take as safe a position as possible, to avoid losses, or to at least limit our losses. I say this on the basis of the following. Everybody loses something in a bear market. If you don't lose it in stock or bonds or futures, you lose it in the value of your home or your land or in the value of your art of jewelry or furniture. And today, as an added feature, if you don't lose it in any of the above listed areas, you lose it as the global value of the dollar declines.

Which is why I say, "In a bear market the person who loses the LEAST is the winner." Be guided accordingly.

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